

Before the  
Federal Communications Commission  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF THE SECRETARY

In the Matter of )

Inquiry Concerning High-Speed )  
Access to the Internet Over )  
Cable and Other Facilities )

GN Docket No. 00-185

**COMMENTS OF THE CONSUMER AND ISP REPRESENTATIVES ON NEED FOR  
RULEMAKING PROCEEDING**

The National Association of Towns and Townships, Citizen Power, Inc., the Utilities Commission, New Smyrna Beach, Florida, Amigo.net, and NorthNet hereby submit their comments in response to the Commission's Notice of Inquiry adopted September 28, 2000 (the "NOP"). The commenters represent a broad coalition of parties interested in promoting competitive access to ISPs over high-speed cable and other facilities. These commenters represent local governments or organizations whose responsibilities include advocating consumer interests in regulatory proceedings. As such they have an affirmative duty to protect the interests of consumers of telecommunications, cable and broadcast services and share the conviction that the interests of all consumers, and in particular those in rural and low income urban areas, are best served by regulations requiring open access to providers of broadband Internet services over cable systems. In addition, these comments are joined by several independent Internet Service Providers ("ISPs") whose competitive interests are also at stake in this proceeding. The state consumer advocates and the ISPs joining these comments are referred to herein as the Consumer and ISP Representatives.

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## EXECUTIVE SUMMARY

The Commission's notice of inquiry was prompted by the decision last spring of the U.S. Circuit Court of Appeals for the Ninth Circuit in *AT&T Corporation, et al. v. City of Portland*.<sup>1</sup> Cable modem service, the court held, is a telecommunications service and cable companies offering cable modem service therefore must do so on terms that are just reasonable and non-discriminatory, unless the Commission is able to conclude that it can forbear from regulating that service. The Commission is bound to honor that ruling. And, since there is no basis on which the Commission can satisfy the statutory standards for forbearance under 47 U.S.C. § 160, it *must* enforce open access to cable systems by independent ISPs on terms that are no less favorable than those on which they provide access to themselves or their ISP affiliates.

Continuation of the Commission's self-described "hands-off" policy on regulation of cable modem services (*NOI*, p. 4) cannot be squared with the statutory command to regulate telecommunications service. Absence an affirmative, written and reasoned decision to forbear, the Commission lacks a legal basis to deregulate by inaction. But open access is not only required by law, it is sound public policy that will advance the deployment of high speed telecommunications services, while also preserving competition in the distinct market for provision of Internet services. The central points underlying our conclusions in that regard are summarized in the comments of the Competitive Access Coalition (to which these commenters are all signatories) and we will not repeat them here. These comments focus, instead, on the questions posed by the Commission concerning the need for a future rulemaking proceeding. Our conclusions are summarized below:

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<sup>1</sup> 216 F.3d at 871 (9<sup>th</sup> Cir. 2000).

1. Short-term, the Commission's leased access rules, including its implicit pricing provisions, can serve as a model for ISP open access regulation. The implicit pricing provisions and complaint procedures can be used to ensure that the cable companies do not price or condition service to unaffiliated ISPs on terms or at rates that are less favorable than they provide to themselves for video programming channels or to their affiliated ISPs for use of cable channels. In the short term, access to ISPs at the cable head end would allow access to multiple ISPs without requiring cable companies to modify their systems or to resolve technical disputes.

In addition, pending a rulemaking, the Commission should declare unenforceable as anticompetitive the exclusive dealing provisions of agreements that the cable companies have executed with their affiliates. Modification of unjust and unreasonable contract terms is wholly within the Commission's powers. *Puerto Rico Telephone Co.*, 92 FCC2d 274 ¶ 36 (1983) (striking down exclusive dealing arrangement in contract); *MCI v FCC*, 665 F.2d 1300 (D.C. Cir. 1981); *In The Matter Of Promotion Of Competitive Networks In Local Telecommunications Markets*, CC Docket No. 96-98, 2000 WL 1593327 (Oct. 25, 2000), ¶¶ 25-27; 163-64. Such relief is needed, moreover, where, as here, the exclusive dealing provisions are tainted by the monopoly power of the cable companies. *See, e.g., Associated Gas Distributors v. FERC*, 824 F.2d 981, 1017 (D.C. Cir. 1987) (interpreting comparable provisions of the Natural Gas Act to modify contracts that were the product of the pipelines' monopoly power.) As AT&T has stated, not only does the Commission have the power to void exclusive dealing provisions in contracts currently in effect (*Promotion Of Competitive Networks In Local Telecommunications Markets, supra* at ¶ 35), such provisions can perpetuate barriers to entry. *Id.*

2. Longer-term, the Commission should consider an open access system in which control of the cable modem platform is divorced from the ownership of the cable system to

ensure that the cable operator does not provide access on preferential terms to its affiliated ISPs. Independent cable modem platform administrators (ICMPAs) or gatekeepers could be created to establish and administer interconnection tariffs and standards.

3. Long-term regulation to ensure open access should also be the product of a rulemaking proceeding where the specifics of ICMIPA responsibilities can be developed and where all parties can consider the respective roles to be played by federal and state regulators.

## COMMENTS

### **I. An Open Access Requirement Is In The Public Interest, Is Readily Implemented, and Is Consistent With Other Regulatory Policies. (NOI 25-31, 43-53)**

Both this Commission and other regulatory agencies have long recognized that the companies they regulate can exert market power through exaction of onerous terms, as well as through unreasonably high prices. Indeed, where the regulated entity competes with its customers, regulators have found it is essential to be vigilant about exclusionary practices. This Commission's co-location rules are a prime example of agency regulation designed to limit the exercise of market power through the imposition of onerous terms and conditions of access. *See, Deployment of Wireline Services Offering Advanced Telecommunications Capability*, cc Docket Nos. 98-147 et al., (Aug. 10, 2000), ¶ 50.

If one were simply talking about a regulated conduit, regulation of rate levels might well provide the basic consumer protection needed against abuse of market power. Where, however, the conduit owner is also in the business of providing competitive goods or services that utilize the conduit facilities, terms and conditions take on added importance. The co-location regulations adopted by the Commission, for example, simply reflect the reality that ILECs not only have "last mile" market power, but utilize that "last mile" to provide Internet and other services in competition with other entities that are reliant on those same facilities. The same

phenomenon can be observed in other conduit or network industries. Thus, oil and gas pipelines have inherent incentives to favor their subsidiaries involved in the sale of oil and gas respectively.<sup>2</sup>

In *American Electric Power Service Corp.*, 67 FERC ¶ 61,168 (1994), the Federal Energy Regulatory Commission approached the same problem. In defining just and reasonable, not unduly discriminatory access, the overarching principle it adopted was a simple but powerful one. FERC announced that it would employ a “golden rule” to govern transmission access. Transmitting utilities would be required to provide service on terms and conditions and at rates no less favorable than they provided to themselves or their affiliates for the carriage of power. *Id.* That principle continues to underpin FERC regulation of electric transmission access.<sup>3</sup> Just as Congress concluded when it passed the 1996 Telecommunications Act, however, FERC concluded that additional steps were necessary to ensure nondiscriminatory access. Thus, it first ordered that all electric utilities file pro forma tariffs adopting standard terms and conditions of access as well as pricing methodologies. *Order No. 888* at 31,734. It later concluded that those steps were inadequate and that unless more aggressive steps were taken to divorce transmission and power supply ownership, transmission providers would continue to favor the sale of their own energy products. *Order No. 2000*, 31,089 at 31,015-17. *See quote* on p. 13. The steps that FERC has chosen, the promotion of independent system operators or ISOs and subsequently, regional transmission organizations (RTOs), are discussed later in these comments in connection

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<sup>2</sup> See, e.g., *FERC Order No. 497*, *FERC Stats. & Regs.*, 930, 820 at 31,129 (1988). Similarly, electric utilities owning transmission facilities and left to their own devices, historically refused to provide access to those competing with them in the sale of power or offer to do so only on terms and conditions that were onerous. See *FERC Order No. 888*, “Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities,” *FERC Stats. & Regs.* ¶ 30,036 at 31,646 (1996); *aff’d. in relevant part, Transmission Access Policy Study Group v. FERC*, 225 F. 3d 667 (D.C. Cir. 2000).

<sup>3</sup> See *Order No. 888*, *supra*.

with questions the Commission has posed about how nondiscriminatory access can be preserved structurally. It is sufficient here to emphasize that the basic “golden rule” adopted by FERC is an equally useful construct to apply to cable access.

In its recently filed White Paper, NorthNet, a Wisconsin ISP, makes essentially this point. It suggests that, in the absence of a court proceeding, the Commission could rely on its existing rules governing leased access to cable channels. NorthNet White Paper at 13. “In this approach,” it states, “the maximum rate for ISP use of 6 MHz of spectrum should be set at the maximum implicit price paid by any entity for leased access to 6 MHz of spectrum for the delivery of cable programming.” This suggestion is well grounded in the statute and the Commission’s regulations, as well as the record amassed by the Commission in *Internet Ventures, Inc.*, File No. CSR-5407-L (February 18, 2000). There, Internet Ventures and the Vermont Department of Public Service both maintained that Internet service providers offered video programming and hence were eligible for leased access under section 612 of the statute. They also provided evidence, unrefuted by other participants, that multiple ISPs could be accommodated on a single cable channel.<sup>4</sup> While the Commission held that the leased access provisions of the Act do not apply to ISPs, they are nonetheless helpful in defining non-discriminatory, just and reasonable rates, terms and conditions of service.

More specifically, although the Commission ultimately rejected the argument that ISPs provide “video programming” within the meaning of section 612, it recognized that video programming might well be delivered over the Internet and that, if an entity were engaged solely in the provision of video programming that was Internet-based, a different question would have been presented. *Internet Ventures, Inc.*, File No. 5407-L (February 18, 2000) ¶ 13. The upshot

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<sup>4</sup> See *Affidavit of Frederick Enns, Attachment 13* to Comments of Competitive Access Coalition.

of that statement is that Internet-based video programming would be entitled to access to cable facilities under the implicit pricing standard established by the Commission's regulations governing leased access. There would simply be no logic to employment of different pricing and access standards for (1) Internet-based video programmers eligible for leased access and (2) ISPs who would obtain access to the same channel capacity. Indeed, cable operators characteristically set up their operations so that their affiliate's Internet service is available over one of the programming channels, "Internet Over Cable," FCC Staff Report at 80. While modifications to the leased access rules to tailor them to ISPs may well make sense as sort of a rulemaking process, in the short term adoption of such rules to ISP access can speed the implementation of open access. The leased access structure of Section 612 is discussed below.

**A. The Leased Access Rules Provide a Useful Temporary Model for Open Access Enforcement**

Congress subjected the prices and conditions offered by cable operators under leased access to a standard of reasonableness, in order to ensure that the rates and terms offered by cable operators would be fashioned "to encourage, and not discourage, use of [leased access] channels." *Media Ranch, Inc. v. Manhattan Cable Television, Inc.*, 757 F. Supp. 310 (S.D.N.Y. 1991) (citing 1984 U.S. Code Cong. & Admin. News at 4688). The 1992 Act sets forth several guidelines that cable companies must follow in the provision of leased access. First, they *must* set aside a percentage of their cable channels for leased access. In other words, they cannot say that they are all booked up by reserving capacity exclusively for their own use. The percentage of channels to be set aside varies depending on the number of "activated channels" in the cable system. Thus, an operator with more than 36 but less than 54 activated channels must set aside for leased access use ten percent of its activated channels "which are not otherwise required for use . . . by Federal law or regulation." 47 U.S.C. § 532(b)(1)(A). Operators with more than 100

activated channels must set aside fifteen percent of their channel capacity for leased access use. *See* 47 U.S.C. §532(b)(1)(C). Second, they must offer leased access at maximum rates and on terms and conditions that are “reasonable.” 47 U.S.C. §532(c)(4). Finally, refusals to provide leased access, or offers to do so that are made under unreasonable terms and conditions, are subject to redress before the Commission. 47 U.S.C. §532(e).<sup>5</sup>

As the Commission has explained these requirements, discrimination in the provision of leased access is inherently unreasonable. Consider, for example, the concept of “implicit fees” embodied in 18 CFR §76.906 and referenced by NorthNet. Under the implicit fee standard, the rate charged to the holder of leased capacity cannot be in excess of the implicit fee charged to other channel users, including the cable operator itself—calculated (in simplified terms) as total subscriber revenue per tier divided by the number of channels in the tier where the channel has been leased. This concept—analogous to the framework that FERC has used to detect “price squeeze”<sup>6</sup>—unambiguously reflects the notion that a discriminatory rate cannot be reasonable. Since, as noted, cable companies themselves made affiliated ISP service available over an existing programming channel, charging customers for the lease of a channel over which they

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<sup>5</sup> That section provides in relevant part:

(1) Any person aggrieved by the failure or refusal of a cable operator to make channel capacity available pursuant to this section may petition the Commission for relief under this subsection upon a showing of prior adjudicated violations of this section. Records of previous adjudications resulting in a court determination that the operator has violated this section shall be considered as sufficient for the showing necessary under this subsection. If the Commission finds that the channel capacity sought by such person has not been made available in accordance with this section, or that the price, terms, or conditions established by such system are unreasonable under subsection (c), the Commission shall, by rule or order, require such operator to make available such channel capacity under price, terms, and conditions consistent with subsection (c). (emphasis added).

<sup>6</sup> Price squeeze cases generally involved claims by municipal utilities or rural electric cooperatives that their wholesale suppliers – who also operated adjacent distribution systems – were charging their wholesale customers more for power supply than they “charged” themselves, thereby giving the wholesale suppliers an unfair competitive advantage in the sale of power at retail. *See, e.g., Federal Power Comm’n v. Conway Corp.*, 426 U.S. 271, 274 (1976). Subsequent to the issuance of the *Conway* decision, FERC developed standards for establishment of a so-called prima facie price squeeze showing. *See* 18 C.F.R. § 2.17.



can receive service from the ISP of their choice, affiliated or unaffiliated, is both simple and sensible.

A model for enforcing non-discriminatory terms and conditions can also be drawn from the leased access framework. The Commission's prohibition against cable company terms and conditions<sup>7</sup> or access decisions<sup>8</sup> based on programming content also reflects the notion that service cannot be discriminatory. In other words, the Commission does not allow a cable operator to base its lease charges (subject to limited exceptions not pertinent here), terms or access decisions (when capacity is insufficient to satisfy the requests of all comers) on the content of the video programming offered by the lessee. The requirement that similar rates be charged to similarly situated customers is a classic formulation of the traditional regulatory prohibition against undue discrimination. *See, e.g., Alabama Electric Cooperative v. FERC*, 684 F.2d 20 (D.C. Cir. 1982).

Finally, under 47 CFR §76.971(a)(4) cable operators must even offer entities requesting part-time leased access time slots "comparable" to those of both leased *and* non-leased programming.<sup>9</sup> In analogous circumstances, the Federal Energy Regulatory Commission has similarly held that, to ensure reasonable, non-discriminatory access to their pipeline and transmission facilities, natural gas pipelines and electric utilities—even though not common

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<sup>7</sup> See 47 CFR §76.971(e) (prohibiting the imposition of access terms and conditions based on programming content and, with exceptions not pertinent here, prohibiting rate differentials based on programming content).

<sup>8</sup> *See, e.g.,* 47 CFR §76.971(a)(3):

On systems with insufficient available leased access capacity to satisfy current leased access demand, cable operators shall be permitted to select from among leased access programmers using objective, content-neutral criteria.

<sup>9</sup> 47 CFR §76.971(a)(4) provides in relevant part that:

Cable operators may accommodate part-time leased access requests by opening additional channels for part-time use or providing comparable time slots on channels currently carrying leased or non-leased access programming. The comparability of time slots shall be determined by objective factors such as day of the week, time of day, and audience share. (emphasis added).

carriers—must offer their competitors in the sale of gas and electric, respectively, access that is “comparable” to the access they provide themselves.<sup>10</sup>

The regulations and cases discussed above give content to the concept of reasonableness governing cable operators’ response to requests for leased access, include an enforcement mechanism and provide a foundation for formulation of a workable open access standard.

**B. The Commission Has the Power to Abrogate The Exclusive Dealing Provisions of the Agreements Between the Major Cable Companies and Their Affiliates.**

Among the obstacles to open access posed by the major cable companies is the alleged impediment posed by their exclusive dealing arrangements with their ISP affiliates, agreements that would lock competitors out of the market for periods of an additional year or more. These contractual provisions should be declared unjust and unreasonable and invalidated. In the comments of the Competitive Access Coalition, the signatories to these comments explained that the Commission has the plain authority to do so and urged it to act. The Commission may conclude that such action requires a rulemaking proceeding or a specific complaint. If so, these commenters urge the Commission to announce its tentative conclusion and to initiate such action as is necessary to invoke its powers to terminate unreasonable exclusive dealing arrangements.

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<sup>10</sup> See, e.g., *Inquiry Concerning the Commission’s Pricing Policy for Transmission Services Provided by Public Utilities Under the Federal Power Act*, 69 F.E.R.C. ¶61,086 (1994) near note 23 (“Comparability of transmission pricing involves a “golden rule of pricing” -- a transmission owner should charge itself on the same or comparable basis that it charges others for the same service.... There is a similar “golden rule of access” - provide the same or comparable services to others as you provide yourself.”) See also, *American Electric Power Service Co.*, 67 FERC ¶ 61,168 (1994); *Order No. 436*, FERC Stats. & Regs., ¶ 30,665 (1985), *aff’d in relevant part*, *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987); *Order No. 636*, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Natural Wellhead Decontrol*, FERC Stats. & Regs. ¶ 30,939 (1992), *aff’d in relevant part*, *United Distribution Cos. v. FERC*, 88 F.3d 1105 (1996); *Order No. 888*, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities*, FERC Stats. & Regs. ¶ 30,036 (1996), *aff’d in relevant part*, *Transmission Access Policy Group v. FERC*, 225 F.3d 667 (D.C. Cir. 2000).

**C. Longer Term, Functional Control Over Access to Cable Modem Service Must Be Transferred to Independent Cable Modem Platform Administrators (ICMPAS) to Ensure Non-Discriminatory Access.**

The “golden rule” principle itself is straightforward, but its reasonable application may be impeded if the cable company remains the gatekeeper. As discussed in more detail below and in the attached affidavit of Nels Pearsall, Keith Reutter and Robert A. Sinclair of Micronomics (*Attachment A*), the consumer and ISP representatives urge the Commission to open a rulemaking on which it can consider the formation of independent cable modem platform administrators (ICMPAs) or gatekeepers to establish and administer interconnection tariffs and standards. These independent entities would be funded through tariff surcharges and would be completely independent of the cable companies. ICMPAs could be structured either with stakeholder boards designed to ensure that no industry segment could control their operations or they could be comprised of disinterested board members. In either case, they would administer tariffs and interconnection arrangements solely to ensure non-discriminatory access and that interconnections were reliable and would not impair the integrity of the cable modem platform. Such an approach, as discussed below, is “less regulatory” than a non-structural, enforcement regime.

At paragraph 30 of the *NOI*, the Commission asks how open access should be “conceptualized” and posits three alternatives:

- (1) A model where each ISP purchases transmission capability and customer access from the cable operator on non-discriminatory prices, terms and conditions, and the cable operator manages the network on a non-discriminatory basis;
- (2) A model where multiple ISPs purchase transmission capability and customer access from the cable operator on non-discriminatory prices, terms and conditions, but an affiliated or preferred ISP manages the network on a non-discriminatory basis; or

- (3) A model where multiple unaffiliated ISPs would obtain access to the cable modem platform according to agreements negotiated between those ISPs and cable operators?

In our view, none of these models is completely satisfactory. Our conclusions are both borne of experience in other network industries and informed by the dismal experience to date with the Commission's "hands-off" version of open access.

Consider first the negotiated agreement model. As discussed at length in the comments of the Competitive Access Coalition, only those cable companies under threat of an antitrust investigation or seeking merger approval from the Commission have even entertained the concept of negotiating access arrangements with unaffiliated ISPs. The term sheets sent by Time Warner to unaffiliated ISPs in Texas and Wisconsin (discussed in the companion comments of the Competitive Access Coalition) provide a useful glimpse into the unsatisfactory world of negotiated arrangements.

Experience in other network industries has uniformly demonstrated that, without defined rules, open access systems that rely on voluntary negotiations are simply doomed to frustrate competition. Thus, oil pipelines are required to file tariffs, as are gas pipelines. The Federal Energy Regulatory Commission imposes similar requirements on electric utilities. This Commission's co-location rules are a similar example of an effort to standardize the process so that less is left to negotiation.

The model under which the affiliated or preferred ISP would manage the network is only marginally better. While such a network manager would be obligated under the model to provide access on a non-discriminatory basis, it would have every incentive to interpret its responsibilities narrowly or, worse, to circumvent them entirely. The experience in other network industries should help inform the Commission's approach here.

FERC again provides a useful example. It concluded that a model under which the fox guards the chicken coop—even if the fox is ordered to behave—simply will not work long term. Thus, FERC has, in stages, concluded that functional separation, standards of conduct, and ultimately divestiture of control is needed to ensure truly non-discriminatory access.

As FERC has observed, allowing the network owner to negotiate access for entities that compete with the network owner's marketing affiliate is simply a means to permit the network owner to exert its market power:

We believe that some of the identified standards of conduct violations are transitional issues resulting from a new way of doing business, and we acknowledge that many utilities are making good-faith efforts to properly implement standards of conduct. However, we also believe that there is great potential for standards of conduct violations that will never even be reported or detected. Moreover, as we stated in the NOPR, [footnote omitted] we are increasingly concerned about the *extensive regulatory oversight and administrative burdens that have resulted from policing compliance with standards of conduct*. The use of standards of conduct is not the best way to correct vertical integration problems. Their use may be unnecessary in a better structured market where operational control and responsibility for the transmission system is structurally separated from the merchant generation function of owners of transmission.

*See FERC Order No. 2, FERC Stats. & Regs. ¶ 31,089 at 31,016 (1999) (emphasis added).* In other words, the independent operator approach reduces the need for regulatory oversight.

Finally, the Commission's first suggested model, under which the cable operator manages the network is, in our view, no better than the second alternative under which its affiliate manages the network. We suggest a consideration of a fourth alternative, discussed above, under which an independent administrator would be in charge of establishing the terms and conditions of interconnection, as well as the prices for access. The rules under which such an independent administrator would manage the system would best be developed through a rulemaking proceeding.

A decision to select the model under which cable companies could continue to negotiate open access arrangements would not affect other providers of high-speed services because it would just be a continuation of the non-productive status quo. On the other hand, if the Commission were to adopt a model that truly requires non-discriminatory access—even an imperfect model—it would likely add competitive pressure on other providers of high-speed services to provide greater access as a means of attracting new business.

**D. Cable Open Access Will Create Competitive Pressure Between Cable and Other High-Speed Service Providers in Markets Where Cable Modem Service Faces Competition.**

The Consumer and ISP Representatives urge the Commission to adopt a non-discrimination model that is cost-based and assures unaffiliated ISPs of access at prices, terms and conditions comparable to those the cable company offers to its affiliates.

In those limited areas where consumers have a choice between DSL and cable platforms to provide high-speed access to Internet service in the Washington metropolitan area, companies like Comcast have offered cable modem service at \$39 per month, a price cable companies have touted as “competitive” with DSL service. Yet, as demonstrated in the Competitive Access Coalition comments, a nonaffiliated ISP needs no more than a single cable channel to provide service to customers. Indeed, multiple ISPs can share the same channels since no customer is likely to purchase ISP service from more than one provider.

It is difficult to imagine that a cost-based access charge for cable modem service could be more than the cost of purchasing a premium channel of video programming from the cable operator—a price typically in the range of \$10 or so. Even premium ISP service with its own proprietary content, from a provider like AOL or MSN, costs no more than \$22 a month. If cable companies offered access to ISPs at \$10 a month per ISP subscriber, the likelihood is that

this would put downward pressure on DSL prices, since the cable modem service price would set the ceiling on a competitive price from DSL providers.

Thus, one benefit of a cost based open access model is that it would likely reduce the price for high-speed Internet access for those customers who do have limited competitive alternatives. Of course, as the Competitive Access Coalition has emphasized elsewhere in its comments, many consumers around the country, particularly in rural and low-income urban areas, only have the cable modem alternative. However, to the extent that cable modem service provides competition to other providers of high-speed access, a cost-based open access platform can only serve to help consumers by driving down the prices that high-speed competitors provide for access to their networks.

The model we suggest would include identical operations support systems interfaces for affiliated and unaffiliated ISPs. While interfaces may change with developments in technology, the surest way to enforce non-discriminatory access is to require that affiliated and unaffiliated ISPs receive the same functional access:

The implementation of router-based technology known as policy-based routing would enable access by multiple service providers to the cable operators' high-speed data networks. This would enable users to select their Internet service provider of choice, and have that provider's service transmitted over the designated Internet channel, somewhat akin to presubscription of a telephone number to a long distance telephone service provider. *See the Canadian Cable Television Association's submission* to the CRTC (the Canadian FCC) in response to Telecom Public Notice 98-9, the "Technical Report on Alternative Methods of Providing Access for Internet Service Providers," August 24, 1998.

Vermont Telecommunications Plan 2000, [www.state.vt.us/psd/tel00.htm](http://www.state.vt.us/psd/tel00.htm) at 3-44 n. 302.

## **II. THE COMMISSION SHOULD COMMENCE A RULEMAKING PROCEEDING TO DEVELOP OPEN ACCESS RULES.**

Earlier in these comments, we urged the Commission to announce that, for the short term, it will apply the leased access model of implicit pricing to govern access by ISPs to the cable


head end. Such an approach can be implemented almost immediately, since it requires the construction of no additional cable infrastructure and would employ existing leased access rules governing the pricing of leased access. It is also essential that an interim solution be adopted to prevent cable companies from becoming entrenched. In addition, pending a rulemaking, the Commission should declare unenforceable as anticompetitive the exclusive dealing provisions of agreements that the cable companies have executed with their affiliates. Modification of unjust and unreasonable contract terms is wholly within the Commission's powers, as discussed in the comments of the Competitive Access Coalition. Such relief is needed, moreover, where, as here, the exclusive dealing provisions are tainted by the monopoly power of the cable companies. *See, e.g., Associated Gas Distributors v. FERC*, 824 F.2d 981, 1017 (D.C. Cir. 1987) (interpreting comparable provisions of the Natural Gas Act to modify contracts that were the product of the pipelines' monopoly power.)

The NOI also asks, however, whether the Commission should institute a rulemaking. We answer this question in the affirmative. Longer-term regulation to ensure open access should also be the product of a rulemaking proceeding where the specifics of open access can be developed and where the parties can discuss the respective roles to be played by the Commission and state regulators.



Respectfully submitted,

By Their Attorneys

  
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# **ATTACHMENT A**

**Before The  
Federal Communications Commission  
Washington, DC**

In the Matter of	)	
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Inquiry Concerning High-Speed	)	
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**NOTICE OF INQUIRY**

Affidavit of

**NELS PEARSALL  
KEITH REUTTER, AND  
ROBERT A. SINCLAIR**

**I. INTRODUCTION**

1. I, Robert A. Sinclair, am an economist and Director at Micronomics. I have a Ph.D. in economics from the University of Pittsburgh. My major fields of expertise include industrial organization, antitrust, regulation, statistical analysis, and microeconomic theory. I have been an economic consultant since 1993 and have provided expert testimony in a number of jurisdictions on matters relating to competition, prices, and cost of service in regulated network industries. I have published articles in academic and professional journals on economics, law, and regulation. These articles appear in *The Review of Industrial Organization*, *The Dickinson Law Review*, and *The Electricity Journal*. I have also spoken on technical and policy matters before the

American Gas Association, the National Association of State Utility Consumer Advocates, and the Institute of Public Utilities. I have taught university courses in industrial organization, antitrust, and microeconomic theory. My biographical summary is set forth at Exhibit 1.

2. I, Keith A. Reutter, am an economist and Director at Micronomics. I hold a Ph.D. in economics from Auburn University. My major fields of expertise include industrial organization, regulation, microeconomic theory, and econometrics. I have provided economic analysis and consulting services since 1995 pertaining to a variety of industries, including network industries and public utilities. I have written and published articles related to economics and regulation. My biographical summary is set forth at Exhibit 2.

3. I, Nels Pearsall, am an economic consultant and Managing Director at Micronomics. I have been engaged in economic research and consulting since 1989. I have managed groups and directed research for a broad range of economic matters, including private antitrust cases and matters before various government agencies. My experience includes cases in attempted monopolization, analyses of entry, predatory pricing, price-fixing, price discrimination, and the exercise of market power. In addition to economic analysis of liability issues, I have provided estimated damages associated with antitrust practices. My biographical summary is set forth at Exhibit 3.

## **II. ASSIGNMENT**

4. We have been asked by certain consumer and Internet Service Provider (“ISP”) representatives to provide an opinion regarding economic issues relating to elements of the Notice of Inquiry (“NOI”) of the Federal Communication Commission

(“FCC”) concerning high-speed access to the internet over cable and other facilities (GN Docket No. 00-185). In particular, we have been asked to address the effectiveness of market-based and regulatory approaches in promoting competition in the provision of broadband Internet service. Our analysis focuses on how efficient and effective competition can be advanced in light of the market structure and other economic conditions in the industry.

5. The following is a description of each entity comprising the consumer and ISP representatives:

- The **National Association of Towns and Townships** is an association of local governmental units that works to strengthen the effectiveness of town and township government.
- The **Utilities Commission, City of New Smyrna Beach** is a municipal electric and water utility that also operates an ISP.
- **Citizen Power, Inc.** is a non profit, public policy research, education, and advocacy organization that promotes public understanding of, and involvement in, socio-cultural, economic and environmental issues, and policy development.
- **NorthNet** is an ISP headquartered in Oshkosh, Wisconsin and provides dial up service in Fond Du Lac, Oshkosh, Mensasha, Neenah, Appleton, and Green Bay, Wisconsin.

### **III. SUMMARY AND CONCLUSIONS**

6. The key relevant market in this case is the broadband network access market. The broadband network access market is an essential input into the provision of broadband Internet access for end users. ISPs require the use of the broadband network access market in order to provide broadband Internet access to end users.

7. With respect to economic policy, we have concluded that the efficient way to provide broadband Internet access is to allow multiple ISPs to offer competitive services using the cable broadband network. We also have concluded that affiliation between the cable broadband network owner and an ISP creates the incentive and opportunity for the network owner to use control of the network to preclude other ISPs. We have further concluded that ISP competition along with its attendant cost and technology benefits would best be accomplished by means of regulated access rates and open-access policies applied to broadband network access, including an independent network operator. This approach is superior to market-based approaches and superior to continued operation of the system by the cable owners under open-access tariffs.

### **IV. MARKET DEFINITION AND MARKET STRUCTURE**

8. To analyze the economic issues involved in the open-access debate, we first define the *relevant market*. Economists define relevant markets in order to facilitate a focused analysis of the economic relationships that are important in a given economic situation. In this instance, defining relevant markets allows us to focus on

broadband Internet access and to evaluate how alternative policies will affect competition, costs, and technology.

9. In defining relevant markets, economists consider substitutability of the product (or service) in question. Section 1 of the Department of Justice (“DOJ”) and Federal Trade Commission (“FTC”) Merger Guidelines sets out well-accepted market definition principles using a “hypothetical monopolist”<sup>1</sup> approach. Under this approach, economists attempt to determine whether a hypothetical monopolist of the product in question can impose a small but profitable price increase. If a price increase results in customers seeking alternative supplies in sufficient numbers to make the price increase unprofitable, the hypothetical monopolist does not control a sufficient number of close substitutes to consider that group of products to be a relevant market. Consumers would turn from the hypothetical monopolist and purchase viable alternatives, undercutting the monopolists’ pricing power. If on the other hand, the price increase is profitable, the products controlled by the hypothetical monopolist could be considered as part of the same relevant market.

10. We initiated our analysis by first considering the extent to which broadband network access provided through an existing cable franchisee and broadband network access over Digital Subscriber Lines (“DSL”) are viable substitutes for ISPs seeking to offer broadband Internet service.<sup>2</sup> While DSL and cable broadband are functionally substitutable, the geographic dispersion of DSL facilities and cable facilities

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<sup>1</sup> U.S. Department of Justice and Federal Trade Commission 1992 *Horizontal Merger Guidelines*, Washington, D.C.; reprinted in 4 Trade Reg. Rep. (CCH) §13,104.

<sup>2</sup> The ISP provides the actual information platform for Internet access. ISPs allow a customer to gain access to multiple information networks, mainly the Internet, but other networks as well. ISP services

limit the availability of competitive options in certain geographic markets. Cable systems provide service to end-users and therefore must locate where people live (i.e. residential areas and suburban areas) while DSL networks are located mostly in areas where commercial activity is high (i.e., commercial districts and urban areas).<sup>3</sup> As a result, in many instances the substitutability between DSL and cable broadband will be limited due to availability.<sup>4</sup>

11. If the large numbers of ISPs are able to gain access to broadband networks, it is our belief that the increase in competition will be beneficial. The current problem however, is the lack of competitive alternatives for network access available to ISPs. Most residential customers' access to a broadband network is restricted to a broadband cable system. According to the FCC, as of June 2000, two-thirds of all high-speed connections to residential and small commercial customers were coaxial cable lines. Furthermore, of the areas in which high-speed data services are available, over 43% of those areas were served only by a single high-speed connection.<sup>5</sup> While the FCC data does not indicate the share of cable lines among these single-supplier areas, in most instances for residential customers, this network will be the monopoly cable franchise. Hence, while competition can prevail among ISPs, competition for broadband network

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also include storage for email and other server-based facilities (like a personal web site) as well as electronic content.

<sup>3</sup> Because of technical constraints, DSL service is available only if a residential customer is near enough to a telephone switching station. Hence, the number of customers near enough to a switching station increases as population density increases.

<sup>4</sup> We also do not consider traditional narrowband "dial up" network access to be an adequate substitute for the broadband network. This is primarily due to the speed of broadband access as compared to narrowband access. While there is some overlap of the services available by these alternative media, with the greater speed, broadband can provide services that would be impossible over narrowband (e.g., video on demand).



access is limited or non-existent for most residential neighborhoods. But even when alternative network access providers are available to a customer, the market is likely to be highly concentrated. Just about all households and small businesses are connected either to a cable system, a DSL line, or both -- but not more than one cable system or DSL line. Hence, the best competitive scenario possible is duopoly. Indeed, according to the FCC (*Id.*), nearly every geographic area of the U.S. analyzed (85%) are served by at most three high-speed network access providers -- and 76% are served by 2 or less providers. Consequently, even if a cable operator is not the only network access provider, the prospect for competition when just two alternatives are present is not much brighter.

## **V. COMPETITION POLICY**

12. A provider of the essential input could have monopoly power if competitive firms require that input (in this case the broadband network) and the provider can control pricing and output of the final good (in this case residential broadband Internet access). We considered two basic competitive scenarios in our assessment of the optimal policy in this case. Each scenario has an impact on prices and innovation and provides a basis for evaluating the optimal policy response.

### *A. Market-Based Pricing and Access*

13. Under a market-based structure, the broadband network owner is not regulated with respect to price or access. In other words, it can charge any price for its network access and is not required to allow competitive access at the ISP level. We assume, for this analysis, the cable owner is integrated with an affiliated ISP. Under this

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<sup>5</sup> See "High-Speed Services for Internet Access: Subscribership as of June 30, 2000," FCC Industry Analysis Division, October 2000, Tables 3 and 6, set forth at Exhibit 4, herein.

scenario, the typical cable owner can set a monopoly price for residential broadband Internet access and share the monopoly profits with its affiliated ISP.<sup>6</sup> This outcome results in two unsatisfactory consequences. First, consumers must pay the supra-competitive price for broadband Internet service -- resulting in fewer customers receiving access (due to the high rates) and resulting in prices that are higher than the cost of providing the service.<sup>7</sup> This is the standard monopoly pricing result that economists almost uniformly disfavor. The second and perhaps the more crucial consequence of this market-based scenario is the fact that the absence of competition will impede the opportunity to advance technology.

14. With competition at the ISP level, there is an increased potential that further innovation in various aspects of Internet technology will be stimulated. These aspects might be otherwise muted under a single integrated supplier regime. In a more competitive environment, individual ISPs will look for ways to differentiate themselves among competitors and will seek to improve service. For example, each ISP could monitor competitors' content and services in an attempt to compete. Additionally, ISPs (or others wishing to sell products to ISPs) might attempt to undertake innovations to differentiate products such as increasing the speed of interconnections along the broadband network and throughout the ISPs' interconnection facilities. The current lack of competition reduces the incentive to innovate among individual ISPs since limited network access is assured.

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<sup>6</sup> It is assumed that the cable owner is the only supplier of network access. We acknowledge that in limited circumstances there may be two suppliers (i.e., duopoly). While duopoly is generally more desirable than monopoly, a duopoly can result in higher than competitive pricing as well, inducing the same, albeit ameliorated, negative consequences as monopoly.

15. The idea that competition among ISPs will stimulate innovation is a particularly important one in the Internet industry. Competition among various players powered much of the innovation that has occurred within industries involved with the Internet. End user access to multiple ISPs, multiple e-commerce sites, and the large variety of other Internet services has introduced a sort of iterative trial and error process. This process, which creates lessons for both users and suppliers through frequent interaction, allows a quickening of Internet innovation. Consequently, providing open access takes on particular importance in this case. The current conditions within the market provide vertically-integrated broadband cable operators few incentives to innovate. Vertically integrated network/ISPs can directly control the price of broadband Internet service. If the network owner allows competing ISPs to gain access to its system, it loses control of pricing and output since the integrated network owner would not set end users' prices. Instead, each individual ISP would have the ability to set its own price. Despite the network owner's ability to control the price charged by individual ISPs, a network owner still has significant market power and can keep prices high.<sup>8</sup> However, under a market-based system, the monopolist will strongly prefer the integrated single supplier system and negotiated access is not likely to be effective.

#### *B. Price Regulation*

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<sup>7</sup> The "cost" in this context includes both out-of-pocket operating costs and capital costs (i.e., depreciation and a return on investor-supplied funds commensurate with the risk of the enterprise).

<sup>8</sup> A rigorous theoretical exercise can show that a monopolist can still dictate the final price to end users even with multiple ISPs. This can be achieved by the monopolist establishing an access charge that is set just equal to the monopoly price that would prevail under the integrated market *less* the ISP's costs. With such a charge, the ISP's cost to serve end users is equal to the monopoly price under integration. With competing ISPs, no ISP can raise their price above their costs. These results appear to suggest that the monopolist would be indifferent between a single integrated supplier and multiple competing suppliers. However, this is a "knife's edge" condition and even the slightest cost to the monopolist from allowing access will dissuade the monopolist from negotiating to allow multiple suppliers.

16. As explained above, in the absence of price regulation, the existence of multiple ISPs does not necessarily eliminate the possibility that a monopolist could earn above-competitive profits. The unregulated broadband network potentially would allow an owner to price in a manner that allows it to earn profits that are higher than that necessary to ensure the financial viability of the network. By restricting the pricing power of the broadband network owner through price regulation, broadband Internet access prices would decline to the level of the cost of providing network service. This would create a wider demand for the service and benefit consumers while still ensuring the viability of the network owner and preserving incentives to invest.

### C. *Open Access*

17. Similar to price regulation, open access to the network would also provide critical economic benefits. As explained above, the integrated network owner lacks incentives to allow access voluntarily.<sup>9</sup> Therefore, public policy should ensure non-discriminatory access by ISPs.<sup>10</sup> With effective competition at the ISP level (induced by open access) in tandem with regulated access charges, consumers will receive broadband Internet access at the lowest possible cost. Consequently, effective open-access ISP policies are essential. However, the integration between a network owner and an ISP creates incentives that cut against the goal of open access (and provision of broadband Internet access at the lowest possible cost). Open access works when ISPs using the

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<sup>9</sup> Some terms demanded by Time Warner in negotiation with ISPs indicate that cable owners maybe motivated in this way. The terms included: • 75 percent of the Internet service providers' revenue from all subscriber fees—which are often their biggest source of sales; • 25 percent of the Internet service providers' revenue from other sources—such as advertising and other e-commerce fees; • a \$50,000 as an upfront deposit; • approval control over the Internet service providers' home pages.

<sup>10</sup> By non-discrimination, we mean the network monopolist is not permitted to offer different prices, terms, and other conditions to similarly situated ISPs.

broadband network are treated in a comparable manner. When a broadband network owner is integrated with an ISP, the network owner has a vested interest in the commercial success of its affiliate. The incentive problems associated with this kind of arrangement are well known. Basically, the integration provides the network owner with vertical market power. Vertical market power is the ability to exert market power in a downstream market as a result of the control of an essential input. This is known as vertical foreclosure.<sup>11</sup>

18. Additionally, investment decisions can be undertaken that benefit one ISP over others. For example, it is possible, at the discretion of the cable franchise, that benefits such as speed and capacity of the system be offered as incentives for those end users who chose the affiliated ISP. While this undermines competition, it is made even worse by the fact that the costs of these investments, under typical regulatory methods, would be allocated among all network users.

19. A regulated enterprise that maintains an unregulated affiliate will have the incentive to report costs incurred by the affiliate as costs to support the regulated activities. For example, executive salaries and other corporate costs and facilities are used to support both the regulated activities as well as the activities of the unregulated

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<sup>11</sup> Vertical foreclosure can arise in at least two ways in the broadband Internet access market. First, the integrated network owner can use its operational and managerial control of the network in a manner that puts unaffiliated ISPs at a disadvantage. The most serious problems arise if the network owner is able to use managerial discretion over operating and investment decisions to provide advantages over rivals. The cable system is a network system that must be shared but which also must be allocated at key junctures. For example, signals from end users sent back over the network out to the Internet must use switches and routers in order to ensure that the end users' ISPs receive proper signals. If a network is not properly configured (or is configured purposefully to favor one ISP over others), the network's affiliated ISP may be able to gain priority access that speeds-up its service relative to its competitors' service or it may simply degrade the perceived reliability of rival ISPs. This effectively allows the network owner to improve the quality of the affiliated ISP product by virtue of controlling the essential facility. The monitoring of such activity is difficult and the opportunity for competitive mischief is high.

affiliate. If the network owner is able to shift costs away from its unregulated affiliate ISP in a regulatory environment and thereby reduce its affiliate's costs, then competing ISPs will be faced with an unfair disadvantage. This is the antithesis of competition -- not only do unaffiliated competitors face an ISP who has artificially lower costs, but the costs are hoisted onto the network which must be paid for by the unaffiliated ISPs. Hence, the anticompetitive activities are being financed by the entities that suffer the consequences.

20. It is important to recognize that the potential for this kind of activity exists. One way to ensure competitive broadband Internet access is to establish an independent entity to operate the broadband network. This Independent Network Operator ("INO") would oversee the key managerial functions of the cable system relating to broadband access. An INO would help ensure that operational decisions and investments are made in a pro competitive fashion. This will enable competition at the ISP level and allow the attendant cost and technology benefits.<sup>12</sup>

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<sup>12</sup> Experience in the electric power industry informs the debate here. Initially in the electric power industry, competitive generators sought access to electric transmission networks in order to sell power. Utilities generally refused and reluctantly allowed restricted access only when required by law. In 1992 the Energy Policy Act provided the Federal Energy Regulatory Commission ("FERC") the authority to initiate open access. The FERC first tried a "comparability standard" which required open access on non-discriminatory terms and conditions by way of open-access tariffs. After experience with tariff-based open access, FERC is moving toward regional Independent System Operators ("ISO") which turn over operational control turned to an independent entity. Given the higher technology involved with data transmission and broadband access as compared to electric generation dispatch, the need for independent control in the broadband network access market is even more compelling. This is because the less transparent workings of routers, switches, and servers associated with network access provide more latitude for undetected and undetectable discriminatory conduct. We also note that recent well-publicized criticisms of the success of restructured electricity markets are related to failures in generation markets, not to the failure of ISOs to ensure non-discriminatory open access to transmission. On the contrary, ISOs have performed well in implementing open access. Criticisms that transmission has been provided on discriminatory terms have largely disappeared where ISOs control the transmission networks.

## **V. SUMMARY AND CONCLUSIONS**

21. The most efficient way to provide residential broadband Internet access is to allow multiple ISPs to offer competitive portal services using a common broadband network. This is best accomplished by means of regulated access rates and open-access policies, including an independent network operator. This approach is superior to market-based approaches and superior to continued operation of the system by the cable owners under open-access tariffs.